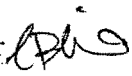


MEMORANDUM

November 7, 2011

To: Audit Committee**From:** Leslie Rubin, Audit Contract Administrator 
Office of Legislative Oversight**SUBJECT:** Addition of Optional Work to Clifton Gunderson Contract

At the Audit Committee's November 8th meeting, Councilmembers will discuss a proposed amendment to Clifton Gunderson's contract with the Council. The proposed amendment has been requested by the Department of Finance. This memo is organized as follows:

- Section A describes the background to the proposed contract amendment.
- Section B describes the proposed amendment.
- Section C summarizes the cost of the proposed amendment.

The people listed below are scheduled to attend the meeting.

| | |
|---------------------------------|--|
| Department of Finance | Joe Beach, Director Karen Hawkins, Chief Operating Officer Lenny Moore, Controller |
| Office of the Inspector General | Ed Blansitt, Inspector General John Hummel, Deputy Inspector General |
| Clifton Gunderson | Keith Novak, Partner |

A. Background

Annually, the Department of Finance performs work to close the County Government's books from the prior fiscal year and to compile the County Government's Comprehensive Annual Financial Report (CAFR). The Department of Finance has incurred challenges in closing the County Government's books for FY 2011 because of problems related to the July 2010 implementation of Oracle business software, the County Government's Enterprise Resource Planning (ERP) system, and because of staff turnover. Currently, the Department of Finance has not completed the closing of the County Government's books for FY11. These delays are preventing the Department of Finance from compiling the County Government's CAFR on its normal timeframe.

Also on an annual basis, Clifton Gunderson LLP performs an annual audit of the County Government's financial statements mandated by the County Charter and County law. Clifton Gunderson performs this work under a contract with the County Council and the Office of Legislative oversight serves as the contract administrator. Among other issues, the delay in the closing of the County Government's books for FY11 has prevented Clifton Gunderson from performing its final fieldwork on the audit of the County Government's FY 2011 financial statements.

This delay has several implications for upcoming deadlines related to the CAFR and to Clifton Gunderson's audit work.

- By December 31, 2011, the County Government must file its financial statements with the Maryland Department of Legislative Services' Office of Legislative Audits.
- By December 31, 2011, the County Government must submit the CAFR to GFOA in order for the County to be eligible to participate in the GFOA's Certificate of Achievement for Excellence in Financial Reporting program and to meet the program's minimum eligibility requirements.
- By March 15, 2012, the County Government must file documents related to the "Single Audit," which is a federally-mandated audit of federal funds received by the County Government in FY11. Clifton Gunderson cannot complete the work related to the Single Audit and issue associated reports until the CAFR is complete.

Keith Novak, the lead Clifton Gunderson partner overseeing the County Government's audit work, has indicated that, the County Government will need to request an extension of the December 31st deadlines.

The County Government does not have an option to request an extension of the federal government's March 15th deadline. If the County Government misses the March 15th deadline, the federal government would reclassify the County Government's status under the Single Audit, requiring the audit of additional County Government programs going forward and increasing the price of the Single Audit work.

While the challenges related to the implementation of the Oracle business software and associated human resource and change management practices may merit more detailed discussion by the GO Committee, the purpose of today's Committee meeting is to address how these challenges are impacting the Department of Finance's ability to finalize its work related to the FY11 financial statements and CAFR and consequently, Clifton Gunderson's ability to perform its audit work and meet the deadlines under its contract.

Department of Finance staff and Mr. Novak will be at today's Committee meeting to answer questions.

B. Department of Finance Request for Additional Services from Clifton Gunderson

In order complete the closing of the County Government's FY11 books, compile the annual CAFR, and meet State and federal deadlines (as extended) related to the production of the CAFR and related to other audit work performed by Clifton Gunderson, the Department of Finance requires the assistance of a public accounting firm possessing expertise with the completion of complex Comprehensive Annual Financial Reports to provide assistance with closing the books, accounting analysis and research, and preparing draft schedules to support the financial statements. Following the transmittal of the CAFR, the Department of Finance would utilize Clifton Gunderson staff to provide accounting research, analysis, and reconciliations and complex technical accounting assistance. The Department of Finance has requested that the Council amend its contract with Clifton Gunderson to allow Clifton Gunderson to perform this additional work. See ©23.

The Council's contract with Clifton Gunderson specifically states that the Council may amend the contract to add this type of work. Under Article I, Section B, Optional Work, the contract states:

[T]he County's Department of Finance may request consulting services on specific financial reporting requirements. The County Council will amend the Contract to add optional work.... Optional work may include, but is not limited to:

- ...
- (2) **Accounting Services** – The County may require professional accounting services from the Contractor to a) assist with the close of the County's books, b) assist with preparation of draft schedules to support each fund and draft financial statements, and c) provide other related professional services.

See ©7.

County Government staff do not believe that this additional work by Clifton Gunderson will create a conflict of interest. Under Generally Accepted Government Auditing Standards established by the U.S. Government Accountability Office, an audit organization and an individual auditor must avoid "personal, external, and organizational impairments to independence, and must avoid the appearance of such impairments of independence."¹ See ©27. Stated more simply, an auditor must avoid a conflict of interest in fact or appearance and maintain its independence.

The question of whether a conflict of interest would arise if Clifton Gunderson provides staff to the Department of Finance under this contract amendment stems from the fact that Clifton Gunderson staff would be performing work to help compile the County Government's financial statements and CAFR and subsequently Clifton Gunderson staff would then perform an audit of these financial statements.

The Department of Finance and Clifton Gunderson have discussed at length steps that they would take to ensure that the work under this contract amendment **would not** jeopardize Clifton Gunderson's independence. This includes:

- The Clifton Gunderson staff working in the Department of Finance would not be the same Clifton Gunderson staff that perform the audit of the County Government's financial statements.
- Clifton Gunderson staff working in the Department of Finance would work under the authority of a Clifton Gunderson partner who is not associated with Clifton Gunderson's audit work for the County Government.
- Clifton Gunderson staff working in the Department of Finance would be supervised by and receive direction directly from Department of Finance staff, not Clifton Gunderson supervisors.
- The Clifton Gunderson staff working in the Department of Finance and the staff performing the audit work would be instructed to never speak with each other.
- The Clifton Gunderson will make its best effort to have the staff working in the Department of Finance come from a different office than the staff performing the audit work.
- The Clifton Gunderson staff working in the Department of Finance would not be allowed to enter any information into or change information in the County Government's financial software.
- The Clifton Gunderson staff working in the Department of Finance would not have any authority to make any management-type decisions.

Staff in the Department of Finance and Mr. Novak believe that these safeguards will create a barrier between the Clifton Gunderson audit work and the Clifton Gunderson work for the Department of Finance that will allow Clifton Gunderson to maintain its independence. In addition, Mr. Novak set as a condition for performing the work under this contract amendment the requirement that the County Government's Inspector General be informed of the proposed arrangement and not raise any objections to it.

¹ Government Auditing Standards, U.S. Government Accountability Office, § 3.01.

Accordingly, on November 4, 2011, Department of Finance staff, Office of Legislative Oversight staff, and Mr. Novak met with the County Government's Inspector General and Deputy Inspector General to seek their opinion. Both the Inspector General and the Deputy Inspector General agreed that the safeguards described above should be sufficient to allow Clifton Gunderson to maintain its independence.

C. Cost

Clifton Gunderson has agreed to perform the requested work at a rate of \$90 per person per hour. See ©25. Due to the high volume of work to be performed, Clifton Gunderson has set this rate at \$50 per hour less than the rate in Clifton Gunderson's contract with the Council for this type of work. The Department of Finance estimates that it will need approximately 4,400 total hours of staff time from Clifton Gunderson personnel to complete the work described in the contract. Accordingly, the Department of Finance has requested that the maximum cost under the contract be set at \$400,000. The Department of Finance would pay for this contract work out of its FY12 operating budget.

D. Contract Amendment

A draft copy of a contract amendment is attached at ©1. This draft has been reviewed for form and legality by the Office of the County Attorney.

Staff recommendation: Recommend that the Council approve contract amendment #7 to Council contract #8031000103AB with Clifton Gunderson.

| Attachment | Begins at... |
|--|---------------------|
| Draft contract amendment # 7 to Council contract # 8031000103AB with Clifton Gunderson | © 1 |
| Council Contract # 8031000103AB with Clifton Gunderson | © 4 |
| November 4, 2011 Department of Finance request to amend Clifton Gunderson LLP contract number 8013000103AB | © 23 |
| November 7, 2011 letter from Keith Novak, Partner, Clifton Gunderson, to Leslie Rubin, Office of Legislative Oversight | © 25 |
| Government Auditing Standards, U.S. Government Accountability Office, Chapter 3 | © 27 |

CONTRACT AMENDMENT #7
CONTRACT NUMBER 8031000103AB

This Amendment is entered into between Montgomery County, Maryland, on behalf of the County Council for Montgomery County, Maryland ("Council"), and Clifton Gunderson LLP, 11710 Beltsville Drive, Suite 300, Calverton, MD 20705 ("Contractor" or "Auditor").

BACKGROUND

1. The Council and Clifton Gunderson entered into Contract No. 8031000103AB on April 24, 2008. Contract No. 8031000103AB was extended through Contract Amendment #6 on April 19, 2011. The current contract term expires on July 23, 2012.
2. Annually, the Department of Finance performs work to close the County Government's books from the prior fiscal year and to compile the County Government's Comprehensive Annual Financial Report (CAFR). The Department of Finance has incurred challenges in closing the County Government's books for FY 2011 because of problems related to the July 2010 implementation of Oracle business software and because of staff turnover. Currently, the Department of Finance has not closed the County Government's books for FY11.
3. Among other issues, the delay in the closing of the County Government's books for FY11 has prevented Clifton Gunderson from performing its field work on the FY11 audit of the County Government's financial statements.
4. In order to meet State and Federal guidelines related to the production of the CAFR and related to other audit work performed by Clifton Gunderson, the Department of Finance requires the assistance of a public accounting firm possessing expertise with the completion of complex Comprehensive Annual Financial Reports to provide assistance with closing the books, accounting analysis and research, and preparing draft schedules to support the financial statements. The Department of Finance has requested that the Council amend its contract with Clifton Gunderson to allow Clifton Gunderson to perform this additional work.
5. Under the Council's contract with Clifton Gunderson, the Council may amend the contract to add this type of work. Under Article I, Section B, Optional Work, the contract states:

[T]he County's Department of Finance may request consulting services on specific financial reporting requirements. The County Council will amend the Contract to add optional work.... Optional work may include, but is not limited to:

...

- (2) **Accounting Services** – The County may require professional accounting services from the Contractor to a) assist with the close of the County's books, b) assist with preparation of draft schedules to support each fund and draft financial statements, and c) provide other related professional services.

CHANGE

1. Article I. "Scope of Work," Paragraph A., Basic Work, is amended by adding the following Subparagraph 13:

- 13) **Work Related to the Completion of the County Government's FY11 Comprehensive Annual Financial Report and Other Work** – The Contractor must provide Contractor personnel to the County's Department of Finance to assist with the completion of the County's FY11 Comprehensive Annual Financial Report, to provide assistance with closing the County's books, to provide accounting analysis and research, and to prepare draft schedules to support the financial statements. Following the transmittal of the CAFR, Contractor personnel will provide accounting research, analysis, and reconciliations and complex technical accounting assistance.

If the Director of the Department of Finance or his designee raises a question about the quality of work performed by a Contractor staff member after the staff member has performed services under this contract, the Contractor will replace the Contractor staff member at a request made in good faith and based on articulable reasons by the Director or his designee.

2. Article V. "Payments", Paragraph A., is amended by adding the following subparagraph 7:

- 7) **Payment for Work Related to the Completion of the County Government's FY11 Comprehensive Annual Financial Report and Other Work** – The County will pay the Contractor an hourly rate of \$90 per person, with a maximum amount not to exceed \$400,000, for accounting services performed to complete the services described in the new Article I. "Scope of Work", Paragraph A., Subparagraph 13. The Department of Finance will pay the Contractor on a monthly basis for work completed during the month, on the condition that the Director of the Department of Finance or his designee determines that the Contractor is making satisfactory progress toward completing these services. The Department of Finance's FY 2012 operating budget is the source of funds. The Contractor's hourly rates for this service are set forth in the Contractor's letter dated November 7, 2011 to Leslie Rubin, Office of Legislative Oversight, and is incorporated by reference and made a part of this contract as Attachment A to this Amendment. The Contractor's monthly invoices for work performed according to this Section must be based on the hourly rate contained in Attachment A to this Amendment. The Director of the Department of Finance or his designee is responsible for approving invoices and paying the Contractor for services satisfactorily performed under this portion of the Contract.

3. Article VIII, Contract Documents and Priority of Documents is amended to include a new item 8 as follows: "(8) November 7, 2011 Letter to Leslie Rubin, Office of Legislative Oversight (Attachment H)."

EFFECT

1. Existing Contract terms remain in effect unless specifically changed by this Amendment.
2. This Amendment is entered into prior to the expiration of the Contract.
3. This Amendment is entered into on the date of signature by the President of the County Council for Montgomery County, Maryland.
4. No goods or services are to be provided pursuant to this Amendment until it is signed by the President of the County Council for Montgomery County, Maryland.

(Signature Page Follows)

WITNESS

Clifton Gunderson LLP

BY: _____
Keith Novak, Partner
Clifton Gunderson LLP

DATE _____

Montgomery County, Maryland

BY: _____
Valerie Ervin, President
Montgomery County Council

DATE _____

Approved to as to form and legality:

BY: _____
Walter Wilson
Assistant County Attorney

DATE _____

CONTRACT NUMBER 8031000103AB

This contract is entered into between MONTGOMERY COUNTY, MARYLAND, on behalf of the County Council for Montgomery County, Maryland (collectively referred to in this Contract as the "County Council," "County" or "Council"), and Clifton Gunderson LLP, 11710 Beltsville Drive, Suite 300, Calverton, MD 20705 ("Contractor").

BACKGROUND

1. Section 315 of the Montgomery County Charter states "The Council shall contract with, or otherwise employ, a certified public accountant to make annually an independent post audit of all financial records and actions of the County, its officials and employees." The Montgomery County Code Section 33-51(c) indicates that an independent audit of the retirement system will be completed annually by the firm of certified public accountants under contract with the Council.
2. On September 25, 2007, the Council's Management and Fiscal Policy (MFP) Committee issued Request for Proposal (RFP) #8031000103 to obtain a Contractor to conduct an independent audit of the basic financial statements of Montgomery County; an independent audit of the basic financial statements of the Montgomery County Employee Retirement Plans; and additional services related to reviews, tests, and certifications.
3. The MFP Committee evaluated the submitted proposals in accordance with evaluation criteria in the RFP and recommended Clifton Gunderson LLP, a certified public accounting firm, for Contract award.
4. The Council adopted Resolution No. 16-501 on April 8, 2008, authorizing the Council President to contract with Clifton Gunderson LLP to conduct the independent audits, reviews, tests, and certifications for the fiscal year ending June 30, 2008.
5. The Council and Contractor agree to the following terms:

ARTICLE I. SCOPE OF WORK

- A. **Basic Work.** The Contractor must complete the following Basic Work upon receipt of a notice-to-proceed from the Contract Administrator:
- 1) **County Government Basic Financial Statements Audit** – The Contractor must audit the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Montgomery County. The Contractor must prepare an Independent Auditors' Report to express opinions on whether the basic financial statements fairly present, in all material respects, the financial position of the County. The Contractor's opinion may place reliance on

Article I. Scope of Work (continued)

reports issued by other Contractors as they relate to component units. The Contractor must conduct the audit in accordance with auditing standards generally accepted in the United State of America and the *Government Auditing Standards* issued by the Comptroller General of the United States.

- 2) **Single Audit** – As required by Federal Office of Management and Budget (OMB) Circular A-133, the Contractor must a) examine the Montgomery County Report on Expenditures of Federal Awards, b) complete the auditor's portion of the Single Audit Act data collection form, c) review internal accounting and administrative controls, d) examine the status of prior year findings and questioned costs, and e) perform any other work required by or necessary for the County to comply with OMB Circular A-133.

The Contractor must prepare:

- An Independent Auditors' Report on Compliance and Internal Control Over Financial Reporting Based on an Audit of Financial Statements in Accordance with *Government Auditing Standards*,
 - An Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program, Internal Control Over Compliance, and Schedule of Expenditures of Federal Awards in Accordance with OMB Circular A-133, and
 - Schedule of findings and questioned costs.
- 3) **Maryland State Uniform Financial Report** – The Contractor must review and attest to the County's uniform financial report submitted to the Maryland State Department of Legislative Services, and transmit completed forms as required.
 - 4) **Arbitrage** – The Contractor must review and report on the calculation of rebate amount under the U.S. Treasury arbitrage rebate requirements (if applicable).
 - 5) **Fiscal Year Closing** – The Contractor must participate in the annual planning meeting with the component units included in the Montgomery County, Maryland reporting entity. Participants will discuss the fiscal year closing process, and identify any issues that may impact the timing of the closing. The Contractor must specifically discuss mandated or proposed accounting and reporting changes that would apply to the current fiscal year and subsequent fiscal years.

Article I. Scope of Work (continued)

- 6) **Agreed-Upon Procedures for the National Transit Database (NTD) Report** – The Contractor must apply agreed-upon procedures to the National Transit Database (NTD) Report prepared by Montgomery County to assist the County to evaluate whether the information included in the Federal Funding Allocation Statistics Form conforms with Federal Transit Administration requirements. The Contractor must prepare an Independent Auditors' Report on applying agreed-upon procedures to the NTD Report's Federal Funding Allocation Statistics Form.
- 7) **Agreed-Upon Procedures for the Chief Financial Officer's Annual Certification of Financial Assurance Mechanisms for Local Government Owners and Operators of Municipal Solid Waste Landfill Facilities** – To comply with Federal Environmental Protection Agency Regulation 40 CFR Part 258, the Contractor must review and perform agreed-upon procedures to the Chief Financial Officer's Annual Certification of Financial Assurance Mechanisms for Local Government Owners and Operators of Municipal Solid Waste Landfill Facilities. The Contractor must prepare an Independent Auditors' Report on Applying Agreed-Upon Procedures.
- 8) **9-1-1 System Audit** – The Contractor must conduct an audit of the Schedule of Maintenance and Operating Revenues and Expenditures of the County's 9-1-1 System. The Contractor must submit a Schedule of Maintenance and Operating Revenues and Expenditures and an Independent Auditors' Report to express opinions on the Schedule of Maintenance and Operating Revenues and Expenditures.
- 9) **Employee Retirement Plans Basic Financial Statements Audit** – The Contractor must audit the Comprehensive Annual Financial Report of the Montgomery County Employee Retirement Plans. The Contractor must prepare:
 - An Independent Auditors' Report to express opinions on whether the financial statements fairly present, in all material respects, the financial position of the retirement plans, and
 - An Independent Auditors' Report on Compliance and Internal Control Over Financial Reporting Based on an Audit of Financial Statements in Accordance with *Government Auditing Standards*.
- 10) **Management Letters** – At the completion of the annual audit, the Contractor must submit two (2) management letters to the Council related to the:
 - a. Basic financial statements of the Montgomery County Government, and
 - b. Basic financial statements of the Montgomery County Employee Retirement Plans.

Article I. Scope of Work (continued)

The letters must communicate any significant deficiencies or control deficiencies found during the audit. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. The Contractor must include comments, recommendations, and suggested improvements in accounting procedures, internal controls, management actions, and other relevant areas. If the Contractor does not find any significant deficiencies or control deficiencies, the Contractor must issue a letter indicating the absence of significant deficiencies or control deficiencies.

11) Government Finance Officers Association (GFOA) Certificates of Achievement for Excellence in Financial Reporting – The Contractor must assist the County to ensure that the following comply with the GFOA standards for the Certificate of Achievement:

- a. The Montgomery County Government Comprehensive Annual Financial Report, and
- b. The Montgomery County Employee Retirement Plans Comprehensive Annual Financial Report.

The GFOA standards require financial disclosure greater than required under generally accepted accounting principles.

B. Optional Work. The Council, acting through the Management and Fiscal Policy (MFP) Committee, may select areas for special attention by the Contractors. Additionally, the County's Department of Finance may request consulting services on specific financial reporting requirements. The County Council will amend the Contract to add optional work. The Contractor will begin work only after receipt of a notice-to-proceed. Optional work may include, but is not limited to:

- 1) **Auditing Services** – The County may require additional audits or audit related services.
- 2) **Accounting Services** – The County may require professional accounting services from the Contractor to a) assist with the close of the County's books, b) assist with preparation of draft schedules to support each fund and draft financial statements, and c) provide other related professional services.

Article I. Scope of Work (continued)

- 3) **Comfort or Consent Letters** – The County may require that the Contractor perform tests and analyses, in accordance with generally accepted auditing standards, to issue a consent letter authorizing the County to use the Auditors' opinion in County debt offering documents.

The County may also require that the Contractor perform tests and analysis, in accordance with generally accepted auditing standards, to update the Contractor's opinion and issue a comfort letter to include in County debt offering documents.

- C. **Additional Work.** The Council may authorize by contract amendment additional work within the general scope of this Contract. The Contractor should not perform any additional work without first signing a contract amendment and receiving a notice-to-proceed from the Contract Administrator.
- D. **Changes to Scope of Services.** The Council may amend the terms of this Contract upon the issuance of accounting or auditing standards that significantly affect the Contractor's scope of work. The Council and Contractor will agree on the Contract modification before the Contractor performs the work. The Contractor will begin work after receipt of a notice-to-proceed.

ARTICLE II. DELIVERABLES

- A. The Contractor must provide up to 20 copies of the following deliverables by December 5th of each year this Contract is in effect to be incorporated in the County Government and Employee Retirement Plans Comprehensive Annual Financial Reports (CAFR) in time for submission for the Government Finance Officers Association (GFOA) Certificate of Achievement for Excellence in Financial Reporting program:
 - 1) Independent Auditors' Report to express opinions on the basic financial statements of the Montgomery County Government (CAFR version),
 - 2) Independent Auditors' Report to express opinions on the basic financial statements of the Montgomery County Government (liftable version),
 - 3) Independent Auditors' Report to express opinions on the basic financial statements of the Montgomery County Employee Retirement Plans, and
 - 4) Independent Auditors' Report on Compliance and Internal Control Over Financial Reporting of the Montgomery County Employee Retirement Plans Based on an Audit of the Financial Statements in Accordance with *Government Auditing Standards*.

Article II. Deliverables (continued)

- B.** The Contractor must provide up to 20 copies of the following deliverables by December 15th of each year this Contract is in effect:

Single Audit

- 1) Independent Auditors' Report on Compliance and Internal Control Over Financial Reporting Based on an Audit of the Financial Statements in Accordance with Government Auditing Standards,
- 2) Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program, Internal Control Over Compliance, and Schedule of Expenditures of Federal Awards in Accordance with OMB Circular A-133,
- 3) Schedule of findings and questioned costs, and
- 4) Auditor's portion of the Single Audit Act data collection form.

Agreed-Upon Procedures

- 5) Independent Auditor's Report on Applying Agreed-Upon Procedures to the Federal Funding Allocation Statistics Form of the National Transit Database Report, and
- 6) Independent Auditor's Report on Applying Agreed-Upon Procedures to the Chief Financial Officer's Annual Certification of Financial Assurance Mechanisms for Local Government Owners and Operators of Municipal Solid Waste Landfill Facilities.

9-1-1 System Audit

- 7) Report on the Schedule of Maintenance and Operating Revenues and Expenditures for the County's 9-1-1 System, including the Independent Auditor's Report on the Schedule of Maintenance and Operating Revenues and Expenditures of the County's 9-1-1 System.

Other

- 8) Auditor signature page of the Maryland State Uniform Financial Report, and
- 9) Report on the calculation of rebate amount under the U.S. Treasury arbitrage rebate requirements (if applicable).

- C.** The Contractor must provide up to 20 copies of the following deliverables by March 1st of each year this Contract is in effect:

- 1) Management Letter related to the audit of the financial statements of Montgomery County, and
- 2) Management Letter related to the audit of the financial statements of the Montgomery County Employee Retirement Plans.

Article II. Deliverables (continued)

D. Additional required deliverables include, but are not limited to the following:

- 1) Before beginning work, the Contractor must submit to the Contract Administrator a written detailed audit plan. The plan must include personnel assignments and estimated completion dates for each major audit segment. The Contractor must also participate in a planning meeting with the Contract Administrator and County staff to review the Contractor's audit plan. The Contractor must make adjustments to the audit plan as requested by the County so long as such adjustments are not contrary to generally accepted accounting or auditing standards.
- 2) The Contractor must submit written monthly reports to the Contract Administrator summarizing progress to date and any accounting or auditing concerns that may impact items in the Scope of Work, and
- 3) The Contractor must brief the Council's Management and Fiscal Policy Committee on the Contractor's reports and Management Letters, provide an overview of mandated or proposed accounting and reporting changes that would apply to the current fiscal year and subsequent fiscal years, and answer Councilmember questions.

E. The Contractor may submit a written request to the Contract Administrator for an extension of a due date for a deliverable when unforeseen circumstances impact the Contractor's work. The Director of the Office of Legislative Oversight, or the Director's designee, will determine, in his or her sole discretion, whether to approve the extension of a due date based on the merits of the Contractor's written request.

F. The Contractor and Council agree that the Council may withhold ten percent (10%) of the final payment to the Contractor in the event of Contractor's failure to provide the deliverables within the time periods designated in this Contract, or within any extended time period approved by the Director of the Office of Legislative Oversight or the Director's designee.

ARTICLE III. CONTRACTOR RESPONSIBILITIES

- A. **Staffing.** The key personnel specified in the Contractor's Proposal dated November 13, 2007 must complete the items in Article I. "Scope of Work". Key personnel include the Engagement Partner-In-Charge, Audit Review Partner, Senior Audit Manager(s), Audit Manager(s), Audit Senior/In-Charge, and Senior Information Technology Specialist.

The Contractor must notify the Contract Administrator in writing if it becomes necessary to replace any of the key personnel. The Contractor must provide the resumes for new personnel assigned to the work, and the new personnel's qualifications and experience must be at least equal to those of the replaced staff. The Contract Administrator must approve the personnel change in writing prior to the change taking place.

- B. **Subcontractors.** The Contractor will subcontract to a certified minority, female, or disabled-owned firm in accordance with the "Minority-Owned Business Addendum to the General Conditions of Contract Between County and Contractor" and the "Minority, Female, Disabled Person Subcontractor Performance Plan." Those documents are attached to this Contract in Attachment B.

- C. **Accounting and Auditing Standards.** The Contractor must conduct the audits in accordance with the accounting and auditing standards listed below, if and as applicable. Each item in Article I. "Scope of Work", Paragraph A. Basic Work is not subject to every accounting and auditing standard listed below. The accounting and auditing standards apply to the individual items in Article I, Paragraph A. based on regulatory and/or accounting industry guidelines. Any Contractor or Contract Administrator uncertainty about which accounting and auditing standards listed below apply to each item in Article I, Paragraph A. will be resolved based on mutual agreement between the Contractor and Contract Administrator.

- 1) Governmental Accounting Standards Board (GASB) "Codification of Governmental Accounting and Financial Reporting Standards" and other GASB publications,
- 2) Generally Accepted Auditing Standards prescribed by the American Institute of Certified Public Accountants, including the industry audit guides for "Audits of State and Local Governmental Units,"
- 3) Government Auditing Standards, 2007 Revision, Comptroller General of the United States,
- 4) Single Audit Act of 1984, as amended in 1996,
- 5) OMB Compliance Supplement of Single Audits of State and Local Governments,
- 6) OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations,"
- 7) OMB Circular A-102, "Grants and Cooperative Agreements with State and Local Governments,"

Article III. Contractor Responsibilities (continued)

- 8) OMB Catalog of Federal Domestic Assistance,
- 9) OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments,"
- 10) Audit Guidelines prescribed by the Legislative Auditor of the State of Maryland,
- 11) Audit Guidelines for examination of 9-1-1 Trust Funds, as prescribed by the Emergency Number Systems Board of the Maryland Department of Public Safety and Correctional Services,
- 12) Examination Guidelines and Certification Requirements prescribed by the Urban Mass Transit Transportation Administration,
- 13) *Federal Information System Controls Auditing Manual*, if applicable,
- 14) *Consideration of Fraud in a Financial Statement Audit* (Statement On Auditing Standards No. 99),
- 15) Government Finance Officers Association's *Governmental Accounting, Auditing, and Financial Reporting*, and
- 16) Other professional auditing/accounting standards issued, as appropriate.

D. Irregularities and Illegal Acts. The Contractor must report promptly in writing any irregularities and illegal acts that the Contractor becomes aware of to the Contract Administrator, County Council President, Chief Administrative Officer, Department of Finance Director, and the Chief of Internal Audit in the Department of Finance.

E. County's Computer System. The Contractor and Subcontractor must comply with the County's computer and e-mail security policies, a copy of which shall be provided to the Contractor and Subcontractor by the County.

F. County's Accounting System and Records. Montgomery County's on-line computerized accounting and financial reporting system, the Financial Accounting Management Information System (FAMIS), will be available to the Contractor. The Contractor must modify techniques and procedures, if necessary, to be compatible with the County's on-line systems. The Contractor must use the on-line nature of the accounting system to the fullest extent possible.

G. Access to County Records and Staff. The Contractor will have access to County records and staff for the purposes of interviews and verification of items within the terms of the audit. The Contractor must coordinate mutually-agreed-upon dates for field work with County personnel. The Contractor must maintain County records as privileged and confidential information. If granted either physical or data rights, the Contractor must only access those items necessary to perform the audit.

Article III. Contractor Responsibilities (continued)

The Contractor must organize the work in such a way as to minimize the disruption of County employees' normal duties. The Contractor must coordinate with County personnel prior to requesting electronic data in order to mutually agree upon relevant data specifications, layout, form of requests, and timing of responses. The Contractor must provide the County at least three (3) full business days to prepare written or oral responses to Contractor requests for information, unless the Contractor and County staff from whom the information is requested agree on an alternative time frame. The Contractor must notify the Contract Administrator if the Contractor and County staff cannot agree on an alternative time frame. The Contract Administrator will negotiate an alternative time frame.

- H. Confidential Information.** Some material reviewed by the Contractor in performance of this Contract will be confidential or proprietary. The Contractor must not divulge confidential or proprietary information to any party other than authorized officers of the County Council and other County officials directly involved in this Contract. The Contractor may be required to sign a confidentiality agreement before being given access to some material.

The County understands and acknowledges that the Contractor is a Certified Public Accounting firm governed by statutes and related regulations regulating the practice of public accounting in the state of Maryland (State). As such, under those statutes and regulations the Contractor is prohibited from disclosing confidential client information. The provisions of this Confidentiality Agreement do not change or alter in any way the Contractor's obligations under those statutes or regulations.

The County also understands and acknowledges that as a firm of Certified Public Accountants, the Contractor is subject to regulatory oversight including "inspection" and "peer reviews" by a variety of bodies including, but not limited to, the Public Company Accounting Oversight Board, the Center for Public Company Audit Firms, the Securities and Exchange Commission, and the boards of accountancy in the states in which the Contractor practices. The County understands and agrees that in order for the Contractor to comply with its obligation for regulatory oversight, the Contractor, without further notice or permission from the County, may provide access to Information subject to this Confidentiality Agreement contained in the files and records of the Contractor for review by regulatory bodies in the normal course of the exercise of their regulatory oversight of the Contractor.

- I. Publication or Release of Data.** The Contractor must not publish or release, without written concurrence of the County Council, any data, tentative conclusions, reports, correspondence, descriptions, procedures, calculations, compilations, or other information relative to this Contract.

Article III. Contractor Responsibilities (continued)

J. Communication with the Component Units Included in the Montgomery County, Maryland Reporting Entity. The component units included in the Montgomery County reporting entity include:

- Montgomery County Public Schools,
- Montgomery Community College,
- Housing Opportunities Commission of Montgomery County,
- Montgomery County Revenue Authority, and
- Bethesda Urban Partnership, Incorporated.

A copy of all correspondence from the Contractor to the component units, as it pertains to the scope of this contract, must be sent to the Controller in the Department of Finance and to the Contract Administrator at the same time the correspondence is sent to the addressee.

K. Other Contracts with the County. To avoid conflict of interest or unfair advantage, the Council's Management and Fiscal Policy Committee must approve any additional work that the Contractor or its affiliates propose to perform for Montgomery County during the period of this Contract. The Contractor must inform the Contract Administrator of additional work the Contractor proposes to complete for the County. The Management and Fiscal Policy Committee must first verify that the proposed work creates no conflict of interest or unfair advantage before the Contractor can undertake such work.

L. Verification and Audits. The Contractor and all subcontractors must maintain for a period of five (5) years, books, records, documents, and other evidence directly pertinent to the performance of work under this contract ("audit documentation"), in accordance with appropriate accounting procedures and generally accepted government auditing standards. The Contractor must make audit documentation available, upon written request, in a timely manner to other auditors or reviewers in accordance with generally accepted government auditing standards. At the County's request, the Contractor must provide proper facilities within its offices during normal business hours, for purposes of making audit documentation available to such other auditors or reviewers.

ARTICLE IV. COUNTY RESPONSIBILITIES

A. Invoices. The County will pay the Contractor within thirty (30) days of approval of the Contractor's invoice.

B. Access to County Records and Staff. The County must provide the Contractor access to County records and reasonable access to the County staff for purposes of interviews and verification of items within the terms of the contract.

Article IV. County Responsibilities (continued)

C. Department of Finance Support. The Department of Finance must provide limited, temporary space to examine records and documents during the audit, and the capability to view on-line documents. The Department of Finance must also:

- 1) Type confirmation requests and other correspondence requesting information from outside entities,
- 2) Provide access to on-line documents, which should be used to the fullest extent possible by the Contractor, and retrieve and replace source documents located in the Department,
- 3) Draft the County Government financial statements, both in preliminary and final forms,
- 4) Type and reproduce the annual report,
- 5) Prepare a closing schedule that highlights the relevant activities and availability dates for workpapers and reports,
- 6) Make available to the Contractor closing workpapers/binders prepared for County funds. The County does not prepare separate schedules under a Prepared by Client (PBC) request, and
- 7) Provide for a planning meeting with County staff and component unit agencies.

D. Board of Investment Trustees Support. The Board of Investment Trustees (BIT) must provide limited, temporary space to examine records and documents during the audit, and the capability to view on-line documents. The BIT must also:

- 1) Draft the Employee Retirement Plans financial statements, both in preliminary and final forms,
- 2) Type confirmation requests and other correspondence requesting information from outside entities,
- 3) Provide access to on-line documents, which should be used to the fullest extent possible by the Contractor, and retrieve and replace source documents located in BIT Offices, and
- 4) Type and reproduce the annual report.

E. Department of Public Works and Transportation Support. The Department of Public Works and Transportation must:

- 1) Participate in an audit planning meeting with the Contract Administrator and Contractor,
- 2) Prepare the National Transit Database Report's Federal Funding Allocation Statistics Form,
- 3) Prepare the passenger mile data collection calculation,
- 4) Provide access to general ledger reports, and
- 5) Provide access to vendor contracts and monthly vendor contractor reports.

Article IV. County Responsibilities (continued)

F. Department of Technology Services Support. The Department of Technology Services must:

- 1) Provide access to appropriate staff for interviews,
- 2) Supply listings, reports, policies, and logs as required to support the audit,
- 3) Generate limited rights audit user IDs for use within the local network, and
- 4) Coordinate all responses to Information Technology requests.

The Department of Technology Services will not provide support for audit work related to the component units included in the Montgomery County, Maryland reporting entity.

ARTICLE V. PAYMENTS

A. Payments for Article I. "Scope of Work," Paragraph A. Basic Work. The Council will pay the Contractor the following fixed fees for the items in Article I. "Scope of Work", Paragraph A. Basic Work:

- 1) **Payment for Subparagraphs 1, 2, 3, 4, 5, 10a, and 11a** – The County will pay the Contractor a fixed fee not to exceed \$243,466 for Fiscal Year 2008 audit services performed under this portion of the Contract. The Council will pay the Contractor on a monthly basis for work completed during the month, on the condition that the Contract Administrator determines, in his or her sole discretion, that the Contractor is making satisfactory progress toward completing all auditing services. The Independent Audit Non-Departmental Account is the source of funds. The Contract Administrator is responsible for approving invoices and paying the Contractor for services satisfactorily performed under this portion of the Contract.
- 2) **Payment for Subparagraph 6** – The County will pay the Contractor a fixed fee not to exceed \$10,000 for Fiscal Year 2008 audit services performed under this portion of the Contract. The County will pay the Contractor in two equal installments, with the first installment paid upon completion of the Contractor's field work, and the second installment paid after the Council accepts the deliverables described in Article II. "Deliverables", Paragraph B., Subparagraph 5. The Independent Audit Non-Departmental Account is the source of funds. The Contract Administrator is responsible for approving invoices and paying the Contractor for services satisfactorily performed under this portion of the Contract.

Article V. Payments (continued)

- 3) **Payment for Subparagraph 7** – The County will pay the Contractor a fixed fee not to exceed \$2,804 for Fiscal Year 2008 audit services performed under this portion of the Contract. The County will pay the Contractor after the Council accepts the deliverables described in Article II. “Deliverables”, Paragraph B., Subparagraph 6. The Solid Waste Disposal Fund will be the source of funds. The Department of Public Works and Transportation is responsible for approving invoices and paying the Contractor for services satisfactorily performed under this portion of the Contract.
- 4) **Payment for Subparagraph 8** – The State of Maryland will pay the Contractor a fixed fee not to exceed \$4,450 for Fiscal Year 2008 audit services performed under this portion of the Contract. The State will pay the Contractor upon the Emergency Number Systems Board’s acceptance of the deliverables described in Article II. “Deliverables”, Paragraph B., Subparagraph 7. Emergency Number Systems Board funds will be the source of funds. The Emergency Number Systems Board is responsible for approving invoices and paying the Contractor for services satisfactorily performed under this portion of the Contract.
- 5) **Payment for Subparagraphs 9, 10b, and 11b** – The County will pay the Contractor a fixed fee not to exceed \$36,720 for Fiscal Year 2008 audit services performed under this portion of the Contract. The County will pay the Contractor on a monthly basis for work completed, on the condition that the Board of Investment Trustees’ designee determines that the Contractor is making satisfactory progress toward completing all auditing services. The Employees’ Retirement System, the Retirement Savings Plan, and the County’s General Fund (on behalf of the Deferred Compensation Plan) will be the source of funds. The Board of Investment Trustees’ designee is responsible for approving invoices and paying the Contractor for services satisfactorily performed under this portion of the Contract.

B. Payments for Article I. “Scope of Work,” Paragraph B. Optional Work. The County will pay the Contractor the following fixed fees for the items in Article I. “Scope of Work”, Paragraph B. Optional Work:

- 1) **Payment for Subparagraphs 1 and 2** – The County will pay the Contractor the following fixed hourly rates for optional auditing and accounting services under a Council-approved amendment to this Contract. The fee will be subject to a not-to-exceed amount established in the Contract amendment. The County will pay the Contractor upon completion of the optional work. The Contract Administrator is responsible for approving invoices and paying the Contractor for services performed under this portion of the Contract.

Article V. Payments (continued)

| Staff Level | Fixed Hourly Rate |
|---|---|
| Partner | \$220 |
| Senior Manager | \$175 |
| Manager | \$140 |
| Senior | \$110 |
| Staff Auditor | \$95 |
| Specialists | To be determined based on required skills |
| Alternate Composite Rate (when already on site) | \$140 |

2) **Payment for Subparagraph 3** – The County will pay the Contractor a fixed fee not to exceed \$2,000 for each:

- Letter consenting to the use of the Contractor's report on the County's Fiscal Year 2008 financial statements.
- Comfort letter related to the County's Fiscal Year 2008 financial statements.

The County will pay the Contractor upon completion of the optional work. The Cost of Issuance appropriation will be the source of funds. The Department of Finance is responsible for approving invoices and paying the Contractor for services performed under this portion of the Contract.

C. Invoices. The Contractor must send all invoices under this Contract to the Contract Administrator, Office of Legislative Oversight, Council Office Building, 100 Maryland Avenue, Rockville, MD 20850. The Contract Administrator will forward invoices to be approved and paid by the Department of Finance, Department of Public Works and Transportation, the Emergency Number Systems Board, and the Board of Investment Trustees to those organizations for approval and payment.

Payments in Excess of the Firm Fixed Fee. If the Contractor reasonably determines that the hours to complete the Scope of Services will exceed the originally estimated amount, the Contractor must submit a written request for additional fees to the Contract Administrator for approval by the Council. The Contractor's written request must include all reasons for the additional time, as well as the new estimate of hours to complete the task. Any additional hours and fees approved by the Council must be authorized by a contract amendment. There is no guarantee that the Council will authorize additional hours or fees.

Article V. Payments (continued)

D. Payments in Subsequent Years. The prices in this Contract are firm for a period of two years after execution of the contract. Any request for a price adjustment after the two-year period is subject to the following:

- 1) Any request for a price adjustment must be submitted in writing to the Contract Administrator and accompanied by supporting documentation justifying the Contractor's request. A request for any price adjustment may not be approved unless the Contractor submits to the County Council sufficient justification to support that the Contractor's request is based on its net increase in costs in delivering the goods/services under the contract;
- 2) Any request for a price adjustment must be submitted sixty (60) days prior to the contract expiration date, if the contract is being amended;
- 3) Any request for a price adjustment may not be approved that exceeds the amount of the annual percentage change of the Consumer Price Index (CPI) for the twelve-month period immediately prior to the date of the request. The request shall be based upon the CPI for all urban consumers issued for the Washington-Baltimore, DC-MD-VA-WV Metropolitan area by the United States Department of Labor, Bureau of Labor Statistics for all items;
- 4) Any price adjustment must be executed by written contract amendment;
- 5) Any price adjustment must be approved by the County Council; and
- 6) The Council will approve only one price adjustment for each contract term, if a price adjustment is approved.

ARTICLE VI. TERM

- A. The term of this Contract is for fifteen (15) months from the date of signature by the Council President. Before the contract term ends, the Council may (but is not required to) renew this contract for three additional one year periods, one year at a time. The Council will determine whether renewal is in the best interest of the County. Contractor's satisfactory performance does not guarantee renewal of this Contract.
- B. During the first engagement period the Contractor will complete the audits of financial statements for the fiscal year ended June 30, 2008. Upon renewal of the Contract, the Contractor will complete the audits of financial statements for the fiscal years ending June 30, 2009, 2010, and 2011.
- C. All provisions that apply after the contract term, including but not limited to guarantees, disputes, and indemnifications, are deemed to survive the term.

ARTICLE VII. CONTRACT ADMINISTRATOR

A. The person identified below functions as the Contract Administrator for this Contract:

Name: Leslie Rubin
Address: Office of Legislative Oversight, 100 Maryland Avenue, Room 509,
Rockville, Maryland 20850
Phone: (240) 777-7998 Fax: (240) 777-7879
E-mail: leslie.rubin@montgomerycountymd.gov

B. The Contract Administrator's duties include, but are not limited to the following:

- 1) Serving as liaison between the County Council and Contractor,
- 2) Giving direction to the Contractor to ensure satisfactory and complete performance,
- 3) Monitoring and inspecting the Contractor's performance to ensure acceptable timeliness and quality,
- 4) Serving as Records Custodian for this contract, including documentation of Wage Requirements,
- 5) Accepting or rejecting the Contractor's performance,
- 6) Furnishing timely written notice of the Contractor's performance failures to the County Council, as appropriate,
- 7) Preparing required reports,
- 8) Approving or rejecting invoices for payment,
- 9) Recommending contract modifications or terminations to the County Council,
- 10) Issuing notices to proceed, and
- 11) Monitoring and verifying compliance with the Minority, Female, Disabled Person Subcontractor Performance Plan.

C. During any prolonged absence of the Contract Administrator, the Director of the Office of Legislative Oversight will serve as the alternate Contract Administrator.

D. Unless the Council President changes this delegation of authority in writing, no other person is authorized to perform the functions of the Contract Administrator for this Contract.


ARTICLE VIII. CONTRACT DOCUMENTS & PRIORITY OF DOCUMENTS

The following documents are incorporated by reference into and made part of this Contract and are listed in order of legal precedence below in the event of a conflict in their terms: (1) the terms contained in this Contract document; (2) the "General Conditions of Contract between County Council and Contractor" (Attachment A) and the "Minority-Owned Business Addendum to the General Conditions of Contract Between County and Contractor" and its companion document "Minority, Female, Disabled Person Subcontractor Performance Plan" (Attachment B); (3) Request for Proposal (RFP) # 8031000103, dated September 25, 2007 (Attachment C); (4) the "Business Associate Agreement" between Council and Contractor (Attachment D); and (5) The Contractor's proposal dated November 13, 2007 (Attachment E).

(Signature Page Follows)


WITNESS:

Clifton Gunderson LLP

BY: 
Keith Novak, Partner
Clifton Gunderson LLP

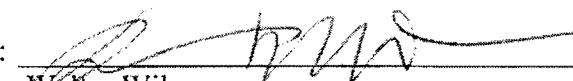
DATE: 4/24/2008

Montgomery County, Maryland

BY: 
Michael Knapp, President
Montgomery County Council

DATE: 24 Apr 08

Approved as to form and legality:

BY: 
Walter Wilson
Associate County Attorney

DATE: 4/11/08



DEPARTMENT OF FINANCE

Isiah Leggett
County Executive

Joseph F. Beach
Director

MEMORANDUM

November 4, 2011

TO: Valerie Ervin, President, County Council
Nancy Navarro, Chair, Audit Committee

FROM: Joseph F. Beach, Director, Department of Finance

SUBJECT: Request to Amend Clifton Gunderson LLP Contract Number 8013000103AB

RECEIVED
MONTGOMERY COUNTY
COUNCIL

11/04/11 - 7 AM 9:30

The Department of Finance (DOF) seeks approval to enter into an amendment with Clifton Gunderson LLP in accordance with Contract Number 8031000103AB, executed between the County Council and Clifton Gunderson LLP. The current contract provides for an independent audit of the basic financial statements of the County; of the Montgomery County Employee Retirement Plans; and additional services related to reviews, tests, and certifications. Under Article I. Scope of Work, Section B. Optional Work, "the County's Department of Finance may request consulting services on specific financial reporting requirements."

This section continues to define optional work to include, but not be limited to, auditing and accounting services. Additionally, Section C., Article I. authorizes the council, via a contract amendment, for additional work within the general scope of the contract. The original contract envisioned the vendor's services could be utilized to assist with the close of the County's books, with preparation of draft schedules for the County's financial statements and provide other related professional services. The DOF has an immediate need for a public accounting firm possessing expertise with the completion of complex Comprehensive Annual Financial Reports, (CAFRs) to provide assistance with closing the books, accounting analysis and research, and preparing draft schedules to support the financial statements. This work, and any resulting recommended adjustments, would be subject to management review, concurrence, and posting to the accounting records, as necessary.

Timing is of the essence, both legally and for continued participation in the prestigious Government Finance Organization Association's (GFOA) Certificate of Achievement for Excellence in Financial Reporting program. Clifton Gunderson staff possess the expertise to perform in a complex government accounting and audit environment. The DOF believes the best option is to employ the services of a firm with knowledge of the County, experience with CAFRs for large complex local governments, and whose superior past performance brings a high level of confidence that their staff will complete all required tasks thoroughly in a complex accounting environment with significant time constraints.

Office of the Director

101 Monroe Street, 15th Floor • Rockville, Maryland 20850 • 240-777-8860 • 240-777-8857 FAX
www.montgomerycountymd.gov

Valerie Ervin, President, County Council
Nancy Navarro, Chair, Audit Committee
November 4, 2011
Page 2

Beginning July 1, 2010, the County began the implementation of all financial records using the Oracle based system. Dedicated staff has been working during the year to implement associated business processes and automation improvements and to reconcile related activity. Significant progress has been made, but we have been unable as of yet to complete the process. In order to complete the CAFR and the associated audit, the DOF estimates that the equivalent of five full-time staff will be required through the transmittal of the CAFR, with three staff continuing into FY12 to provide accounting research, analysis, and reconciliations and complex technical accounting assistance in an automated environment. In-house expertise is not the issue – it will simply take too long to accomplish all tasks simultaneously in a very compressed timeframe.

The Department understands that it is imperative for Clifton Gunderson LLP to operate with total independence as it performs its audit of the basic financial statements of the County, the Employee Retirement Plans, and any other services related to reviews, tests, and certifications. Towards that end, Clifton Gunderson management has asserted, and DOF concurs, that no staff performing work to assist with closing the books, providing accounting research, or accounting consulting services will engage in work related to the audit on behalf of the Council. The DOF will take any and all steps to guarantee the separation and transparency of this arrangement. DOF has affirmed with Clifton Gunderson its management commitment to independence in fact and appearance.

The total estimated cost for the amendment to the Contract is \$400,000 and will be funded through current appropriations to the DOF.

Considering the need for immediate, intensive year-end closing and associated accounting services in an automation-based environment to complete the CAFR in a compressed timeframe, and that Clifton Gunderson is ready to deploy this expertise by the required delivery due date, approval is requested from the Council's Audit Committee to amend its contract for the DOF to engage these services.

Please feel free to contact me at 240-777-8870, Karen Hawkins at 240-777-8828, or Lenny Moore at 240-777-8802 should you have any questions or wish to further discuss this request.

JFB:blf

c: Timothy L. Firestine, Chief Administrative Officer
Kathleen Boucher, Assistant Chief Administrative Officer
Karen Hawkins, Department of Finance
Lenny Moore, Department of Finance



**Clifton
Gunderson LLP**
Certified Public Accountants & Consultants

November 7, 2011

Ms. Leslie Rubin, Legislative Analyst
Montgomery County Government
Office of Legislative Oversight
100 Maryland Avenue
Rockville, Maryland 20850

Dear Ms. Rubin:

This letter is to outline the events and discussions which have taken place regarding the contract amendment which has been requested by the Department of Finance. The County implemented a new ERP system – ORACLE during the current year, and within this resides the general ledger system of the county. The ERP system is a very integrated and complex system and the migration from the County's legacy system (FAMIS) to this new system is a very complicated undertaking. We understand that the County planned for this migration and the plan was implemented as anticipated; however, issues have arisen, which coupled with a reduction in County staff has resulted in a delay by the County in completing the required work needed to close the year and prepare financial statements. The Finance department has postponed the initial audit start date and informed Clifton Gunderson that they were encountering issues with the new system which was the cause for the delays. Mr. Lenny Moore, Controller, approached me to determine if Clifton Gunderson could aid in the County in closing the year.

I discussed this matter with my National Assurance services group to determine if we could offer these services to the County and maintain our independence in both fact and appearance. The conclusion was that we could provide these services as long as certain conditions were met, among which were as follows:

- Personnel assigned could not be also assigned to the audit of the County
- CG would utilize personnel from offices other than Baltimore, to the extent possible
- CG personnel have to be adequately supervised by the County finance department
- CG personnel would have only read access to the County's computer system
- CG's work would be limited to analysis, preparation of draft schedules and other related services
- All journal entries are to be prepared and reviewed by County personnel
- CG personnel would not report internally to the audit partner on the Montgomery County account, nor are they to speak to other CG personnel assigned to the Montgomery County audit relating to Montgomery County matters
- The Office of Inspector General of the County would need to be made aware of, and approve of the services and structure under which they would be provided
- Those charged with governance would need to be made aware and approve of the services and the manner under which they would be structured

*Timonium Corporate Center
9515 Deereco Road, Suite 500
Timonium, Maryland 21093
tel: 410-453-0900
fax: 410-453-0914*

www.cliftoncpa.com




25

Ms. Leslie Rubin, Legislative Analyst
Montgomery County Government
November 7, 2011
Page 2

We have met with both the Finance department personnel (Joseph Beach, Karen Hawkins and Lenny Moore) and the Office of Inspector General (Ed Blansitt and John Hummel) to discuss the conditions under which the services are to be performed. No objections were raised.

Therefore, based upon the conditions outlined above and discussions to date, we believe that Clifton Gunderson can provide the services requested by the County.

We propose to provide personnel for the completion of this project at the cost of \$90 per hour. We also would request the County to provide parking facilities for the individuals assigned.

A handwritten signature in black ink, appearing to read "Keith F. Novak". The signature is stylized with a large, looped "K" and "N".

Keith F. Novak, CPA
Partner

KFN/esc

Chapter 3: General Standards

Introduction

3.01 This chapter establishes general standards and provides guidance for performing financial audits, attestation engagements, and performance audits under generally accepted government auditing standards (GAGAS). (See chapter 6 for an additional general standard applicable only to attestation engagements.) These general standards, along with the overarching ethical principles presented in chapter 2, establish a foundation for credibility of auditors' work. These general standards emphasize the independence of the audit organization and its individual auditors; the exercise of professional judgment in the performance of work and the preparation of related reports; the competence of audit staff; audit quality control and assurance; and external peer reviews.

Independence

3.02 In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be free from personal, external, and organizational impairments to independence, and must avoid the appearance of such impairments of independence.

3.03 Auditors and audit organizations must maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by objective third parties with knowledge of the relevant information. Auditors should avoid situations that could lead objective third parties with knowledge of the relevant information to conclude that the auditors are not able to maintain independence and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work.

3.04 When evaluating whether independence impairments exist either in fact or appearance with respect to the entities for which audit organizations perform audits or attestation engagements, auditors and audit organizations must take into account the three general classes of impairments to independence--personal, external, and organizational.²⁰ If one or more of these impairments affects or can be perceived to affect independence, the audit organization (or auditor) should decline to perform the work--except in those situations in which an audit organization in a government entity, because of a legislative requirement or for other reasons, cannot decline to perform the work, in which case the government audit organization must disclose the impairment(s) and modify the GAGAS compliance statement. (See paragraphs 1.12 and 1.13.)

3.05 When auditors use the work of a specialist,²¹ auditors should assess the specialist's ability to perform the work and report results impartially as it relates to their relationship with the program or entity under audit. If the specialist's independence is impaired, auditors should not use the work of that specialist.

3.06 If an impairment to independence is identified after the audit report is issued, the audit organization should assess the impact on the audit. If the audit organization concludes that it did not comply with GAGAS, it should determine the impact on the auditors' report and notify entity management, those charged with governance, the requesters, or regulatory agencies that have jurisdiction over the audited entity and persons known to be using the audit report about the

independence impairment and the impact on the audit. The audit organization should make such notifications in writing.

Personal Impairments

3.07 Auditors participating on an audit assignment must be free from personal impairments to independence.**22** Personal impairments of auditors result from relationships or beliefs that might cause auditors to limit the extent of the inquiry, limit disclosure, or weaken or slant audit findings in any way. Individual auditors should notify the appropriate officials within their audit organizations if they have any personal impairment to independence. Examples of personal impairments of individual auditors include, but are not limited to, the following:

a. immediate family or close family member²³ who is a director or officer of the audited entity, or, as an employee of the audited entity, is in a position to exert direct and significant influence over the entity or the program under audit;

b. financial interest that is direct, or is significant/material though indirect, in the audited entity or program;²⁴

c. responsibility for managing an entity or making decisions that could affect operations of the entity or program being audited; for example, serving as a director, officer, or other senior position of the entity, activity, or program being audited, or as a member of management in any decision making, supervisory, or ongoing monitoring function for the entity, activity, or program under audit;

d. concurrent or subsequent performance of an audit by the same individual who maintained the official accounting records when such services involved preparing source documents or originating data, in electronic or other form; posting transactions (whether coded by management or not coded); authorizing, executing, or consummating transactions (for example, approving invoices, payrolls, claims, or other payments of the entity or program being audited); maintaining an entity's bank account or otherwise having custody of the audited entity's funds; or otherwise exercising authority on behalf of the entity, or having authority to do so;

e. preconceived ideas toward individuals, groups, organizations, or objectives of a particular program that could bias the audit;

f. biases, including those resulting from political, ideological, or social convictions that result from membership or employment in, or loyalty to, a particular type of policy, group, organization, or level of government; and

g. seeking employment during the conduct of the audit with an audited organization.

3.08 Audit organizations and auditors may encounter many different circumstances or combinations of circumstances that could create a personal impairment. Therefore, it is impossible to identify every situation that could result in a personal impairment. Accordingly, audit organizations should include as part of their quality control system procedures to identify personal impairments and help ensure compliance with GAGAS independence requirements. At a minimum, audit organizations should

a. establish policies and procedures to identify, report, and resolve personal impairments to independence,

b. communicate the audit organization's policies and procedures to all auditors in the organization and promote understanding of the policies and procedures,

c. establish internal policies and procedures to monitor compliance with the audit organization's policies and procedures,

d. establish a disciplinary mechanism to promote compliance with the audit organization's policies and procedures,

e. stress the importance of independence and the expectation that auditors will always act in the public interest, and

f. maintain documentation of the steps taken to identify potential personal independence impairments.

3.09 When the audit organization identifies a personal impairment to independence prior to or during an audit, the audit organization should take action to resolve the impairment in a timely manner. In situations in which the personal impairment is applicable only to an individual auditor or a specialist on a particular audit, the audit organization may be able to eliminate the personal impairment. For example, the audit organization could remove that auditor or specialist from any work on that audit or require the auditor or specialist to eliminate the cause of the personal impairment. If the personal impairment cannot be eliminated, the audit organization should withdraw from the audit. In situations in which auditors employed by government entities cannot withdraw from the audit, they should follow paragraph 3.04.

External Impairments

3.10 Audit organizations must be free from external impairments to independence. Factors external to the audit organization may restrict the work or interfere with auditors' ability to form independent and objective opinions, findings, and conclusions. External impairments to independence occur when auditors are deterred from acting objectively and exercising professional skepticism by pressures, actual or perceived, from management and employees of the audited entity or oversight organizations. For example, under the following conditions, auditors may not have complete freedom to make an independent and objective judgment, thereby adversely affecting the audit:

a. external interference or influence that could improperly limit or modify the scope of an audit or threaten to do so, including exerting pressure to inappropriately reduce the extent of work performed in order to reduce costs or fees;

b. external interference with the selection or application of audit procedures or in the selection of transactions to be examined;

c. unreasonable restrictions on the time allowed to complete an audit or issue the report;

d. externally imposed restriction on access to records, government officials, or other individuals needed to conduct the audit;

e. external interference over the assignment, appointment, compensation, and promotion of audit personnel;

f. restrictions on funds or other resources provided to the audit organization that adversely affect the audit organization's ability to carry out its responsibilities;

g. authority to overrule or to inappropriately influence the auditors' judgment as to the appropriate content of the report;

h. threat of replacing the auditors over a disagreement with the contents of an audit report, the auditors' conclusions, or the application of an accounting principle or other criteria; and

i. influences that jeopardize the auditors' continued employment for reasons other than incompetence, misconduct, or the need for audits or attestation engagements.

3.11 Audit organizations should include policies and procedures for identifying and resolving external impairments as part of their quality control system for compliance with GAGAS independence requirements.

Organizational Independence

3.12 The ability of audit organizations in government entities to perform work and report the results objectively can be affected by placement within government, and the structure of the government entity being audited. Whether reporting to third parties externally or to top

management within the audited entity internally, audit organizations must be free from organizational impairments to independence with respect to the entities they audit. Impairments to organizational independence result when the audit function is organizationally located within the reporting line of the areas under audit or when the auditor is assigned or takes on responsibilities that affect operations of the area under audit.

Organizational Independence for External Audit Organizations

3.13 External audit organizations can be presumed to be free from organizational impairments to independence when the audit function is organizationally placed outside the reporting line of the entity under audit and the auditor is not responsible for entity operations. Audit organizations in government entities can meet the requirement for organizational independence in a number of ways and may be presumed to be free from organizational impairments to independence from the audited entity if the audit organization is

- a.** at a level of government other than the one to which the audited entity is assigned (federal, state, or local); for example, federal auditors auditing a state government program; or
- b.** in a different branch of government within the same level of government as the audited entity; for example, legislative auditors auditing an executive branch program.

3.14 Audit organizations in government entities may also be presumed to be free from organizational impairments if the head of the audit organization meets any of the following criteria:

- a.** directly elected by voters of the jurisdiction being audited;
- b.** elected or appointed by a legislative body, subject to removal by a legislative body, and reports the results of audits to and is accountable to a legislative body;
- c.** appointed by someone other than a legislative body, so long as the appointment is confirmed by a legislative body and removal from the position is subject to oversight or approval by a legislative body,²⁵ and reports the results of audits to and is accountable to a legislative body; or
- d.** appointed by, accountable to, reports to, and can only be removed by a statutorily created governing body, the majority of whose members are independently elected or appointed and come from outside the organization being audited.

3.15 In addition to the presumptive criteria in paragraphs 3.13 and 3.14, GAGAS recognize that there may be other organizational structures under which audit organizations in government entities could be considered to be free from organizational impairments and thereby be considered organizationally independent for reporting externally. These structures provide safeguards to prevent the audited entity from interfering with the audit organization's ability to perform the work and report the results impartially. For an external audit organization to be considered free from organizational impairments under a structure different from the ones listed in paragraphs 3.13 and 3.14, the audit organization should document how each of the following safeguards were satisfied and provide the documentation to those performing quality control monitoring and to the external peer reviewers to determine whether all the necessary safeguards have been met.

- a.** statutory protections that prevent the audited entity from abolishing the audit organization;
- b.** statutory protections that require that if the head of the audit organization is removed from office, the head of the agency report this fact and the reasons for the removal to the legislative body;
- c.** statutory protections that prevent the audited entity from interfering with the initiation, scope, timing, and completion of any audit;
- d.** statutory protections that prevent the audited entity from interfering with audit reporting, including the findings and conclusions or the manner, means, or timing of the audit organization's reports;

e. statutory protections that require the audit organization to report to a legislative body or other independent governing body on a recurring basis;

f. statutory protections that give the audit organization sole authority over the selection, retention, advancement, and dismissal of its staff; and

g. statutory access to records and documents related to the agency, program, or function being audited and access to government officials or other individuals as needed to conduct the audit.²⁶

Organizational Independence for Internal Audit Functions

3.16 Certain federal, state, or local government entities employ auditors to work for management of the audited entities. These auditors may be subject to administrative direction from persons involved in the entity management process. Such audit organizations are internal audit functions and are encouraged to use the Institute of Internal Auditors (IIA) International Standards for the Professional Practice of Internal Auditing in conjunction with GAGAS. Under GAGAS, a government internal audit function can be presumed to be free from organizational impairments to independence for reporting internally if the head of the audit organization meets all of the following criteria:

a. is accountable to the head or deputy head of the government entity or to those charged with governance;

b. reports the audit results both to the head or deputy head of the government entity and to those charged with governance;

c. is located organizationally outside the staff or line-management function of the unit under audit;

d. has access to those charged with governance; and

e. is sufficiently removed from political pressures to conduct audits and report findings, opinions, and conclusions objectively without fear of political reprisal.

3.17 The internal audit organization should report regularly to those charged with governance.

3.18 When internal audit organizations that are free of organizational impairments perform audits of external parties such as auditing contractors or outside party agreements, and no personal or external impairments exist, they may be considered independent of the audited entities and free to report objectively to the heads or deputy heads of the government entities to which they are assigned, to those charged with governance, and to parties outside the organizations in accordance with applicable law, rule, regulation, or policy.

3.19 The internal audit organization should document the conditions that allow it to be considered free of organizational impairments to independence for internal reporting and provide the documentation to those performing quality control monitoring and to the external peer reviewers to determine whether all the necessary safeguards have been met.

Organizational Independence When Performing Nonaudit Services

3.20 Audit organizations at times may perform other professional services (nonaudit services) that are not performed in accordance with GAGAS. Audit organizations that provide nonaudit services must evaluate whether providing the services creates an independence impairment either in fact or appearance with respect to entities they audit.²⁷ Based on the facts and circumstances, professional judgment is used in determining whether a nonaudit service would impair an audit organization's independence with respect to entities it audits.

3.21 Audit organizations in government entities generally have broad audit responsibilities and, therefore, should establish policies and procedures for accepting engagements to perform nonaudit services so that independence is not impaired with respect to entities they audit. (See appendix I, paragraphs A3.02 and A3.03 for examples of nonaudit services that are generally specific to audit organizations in government entities that generally do not impair the

organizations' independence with respect to the entities it audits and, therefore, do not require compliance with the supplemental safeguards described in paragraph 3.30.) Independent public accountants may provide audit and nonaudit services (commonly referred to as consulting) under contractual commitments to an entity and should determine whether nonaudit services they have provided or are committed to provide have a significant or material effect on the subject matter of the audits.

Overarching Independence Principles

3.22 The following two overarching principles apply to auditor independence when assessing the impact of performing a nonaudit service for an audited program or entity: (1) audit organizations must not provide nonaudit services that involve performing management functions or making management decisions and (2) audit organizations must not audit their own work or provide nonaudit services in situations in which the nonaudit services are significant or material to the subject matter of the audits.²⁸

3.23 In considering whether audits performed by the audit organization could be significantly or materially affected by the nonaudit service, audit organizations should evaluate (1) ongoing audits; (2) planned audits; (3) requirements and commitments for providing audits, which includes laws, regulations, rules, contracts, and other agreements; and (4) policies placing responsibilities on the audit organization for providing audit services.

3.24 If requested²⁹ to perform nonaudit services that would impair the audit organization's ability to meet either or both of the overarching independence principles for certain types of audit work, the audit organization should inform the requestor and the audited entity that performing the nonaudit service would impair the auditors' independence with regard to subsequent audit or attestation engagements.

Types of Nonaudit Services

3.25 Nonaudit services generally fall into one of the following categories (see appendix I, paragraphs A3.02 and A3.03 for examples of nonaudit services that are generally unique to audit organizations in government entities):

a. Nonaudit services that do not impair the audit organization's independence with respect to the entities it audits and, therefore, do not require compliance with the supplemental safeguards in paragraph 3.30. (See paragraphs 3.26 and 3.27.)

b. Nonaudit services that would not impair the audit organization's independence with respect to the entities it audits as long as the audit organization complies with the supplemental safeguards in paragraph 3.30. (See paragraph 3.28.)

c. Nonaudit services that do impair the audit organization's independence. Compliance with the supplemental safeguards will not overcome this impairment. (See paragraph 3.29.)

Nonaudit Services That Do Not Impair Auditor Independence

3.26 Nonaudit services in which auditors provide technical advice based on their technical knowledge and expertise do not impair auditor independence with respect to entities they audit and do not require the audit organization to apply the supplemental safeguards. However, auditor independence would be impaired if the extent or nature of the advice resulted in the auditors' making management decisions or performing management functions.

3.27 Examples of the types of services considered as providing technical advice include the following:

a. participating in activities such as commissions, committees, task forces, panels, and focus groups as an expert in a purely advisory, nonvoting capacity to

(1) advise entity management on issues based on the auditors' knowledge or

(2) address urgent problems;

b. providing tools and methodologies, such as guidance and good business practices, benchmarking studies, and internal control assessment methodologies that can be used by management; and

c. providing targeted and limited technical advice to the audited entity and management to assist them in activities such as (1) answering technical questions or providing training, (2) implementing audit recommendations, (3) implementing internal controls, and (4) providing information on good business practices.

Nonaudit Services That Would Not Impair Independence if Supplemental Safeguards Are Implemented

3.28 Services that do not impair the audit organization's independence with respect to the entities they audit so long as they comply with supplemental safeguards include the following:

a. providing basic accounting assistance limited to services such as preparing draft financial statements that are based on management's chart of accounts and trial balance and any adjusting, correcting, and closing entries that have been approved by management; preparing draft notes to the financial statements based on information determined and approved by management; preparing a trial balance based on management's chart of accounts; maintaining depreciation schedules for which management has determined the method of depreciation, rate of depreciation, and salvage value of the asset (If the audit organization has prepared draft financial statements and notes and performed the financial statement audit, the auditor should obtain documentation from management in which management acknowledges the audit organization's role in preparing the financial statements and related notes and management's review, approval, and responsibility for the financial statements and related notes in the management representation letter. The management representation letter that is obtained as part of the audit may be used for this type of documentation.);

b. providing payroll services when payroll is not material to the subject matter of the audit or to the audit objectives. Such services are limited to using records and data that have been approved by entity management;

c. providing appraisal or valuation services limited to services such as reviewing the work of the entity or a specialist employed by the entity where the entity or specialist provides the primary evidence for the balances recorded in financial statements or other information that will be audited; valuing an entity's pension, other post-employment benefits, or similar liabilities provided management has determined and taken responsibility for all significant assumptions and data;

d. preparing an entity's indirect cost proposal³⁰ or cost allocation plan provided that the amounts are not material to the financial statements and management assumes responsibility for all significant assumptions and data;

e. providing advisory services on information technology limited to services such as advising on system design, system installation, and system security if management, in addition to the safeguards in paragraph 3.30, acknowledges responsibility for the design, installation, and internal control over the entity's system and does not rely on the auditors' work as the primary basis for determining (1) whether to implement a new system, (2) the adequacy of the new system design, (3) the adequacy of major design changes to an existing system, and (4) the adequacy of the system to comply with regulatory or other requirements;

f. providing human resource services to assist management in its evaluation of potential candidates when the services are limited to activities such as serving on an evaluation panel of at least three individuals to review applications or interviewing candidates to provide input to management in arriving at a listing of best qualified applicants to be provided to management; and

g. preparing routine tax filings based on information provided by the audited entity .

Nonaudit Services That Impair Independence

3.29 Compliance with supplemental safeguards will not overcome independence impairments in this category. By their nature, certain nonaudit services directly support the entity's operations and impair the audit organization's ability to meet either or both of the overarching independence principles in paragraph 3.22 for certain types of audit work. Examples of the types of services under this category include the following:

- a.** maintaining or preparing the audited entity's basic accounting records or maintaining or taking responsibility for basic financial or other records that the audit organization will audit;
- b.** posting transactions (whether coded or not coded) to the entity's financial records or to other records that subsequently provide input to the entity's financial records ;
- c.** determining account balances or determining capitalization criteria;
- d.** designing, developing, installing, or operating the entity's accounting system or other information systems that are material or significant to the subject matter of the audit;
- e.** providing payroll services that (1) are material to the subject matter of the audit or the audit objectives, and/or (2) involve making management decisions;
- f.** providing appraisal or valuation services that exceed the scope described in paragraph 3.28 c;
- g.** recommending a single individual for a specific position that is key to the entity or program under audit, otherwise ranking or influencing management's selection of the candidate, or conducting an executive search or a recruiting program for the audited entity;
- h.** developing an entity's performance measurement system when that system is material or significant to the subject matter of the audit;
- i.** developing an entity's policies, procedures, and internal controls;
- j.** performing management's assessment of internal controls when those controls are significant to the subject matter of the audit;
- k.** providing services that are intended to be used as management's primary basis for making decisions that are significant to the subject matter under audit;
- l.** carrying out internal audit functions, when performed by external auditors; and
- m.** serving as voting members of an entity's management committee or board of directors, making policy decisions that affect future direction and operation of an entity's programs, supervising entity employees, developing programmatic policy, authorizing an entity's transactions, or maintaining custody of an entity's assets.³¹

Supplemental Safeguards for Maintaining Auditor Independence When Performing Nonaudit Services

3.30 Performing nonaudit services described in paragraph 3.28 will not impair independence if the overarching independence principles stated in paragraph 3.22 are not violated. For these nonaudit services, the audit organization should comply with each of the following safeguards:

- a.** document its consideration of the nonaudit services, including its conclusions about the impact on independence;
- b.** establish in writing an understanding with the audited entity regarding the objectives, scope of work, and product or deliverables of the nonaudit service; and management's responsibility for (1) the subject matter of the nonaudit services, (2) the substantive outcomes of the work, and (3) making any decisions that involve management functions related to the nonaudit service and accepting full responsibility for such decisions;
- c.** exclude personnel who provided the nonaudit services from planning, conducting, or reviewing audit work in the subject matter of the nonaudit service;³² and

d. do not reduce the scope and extent of the audit work below the level that would be appropriate if the nonaudit service were performed by an unrelated party.

Professional Judgment

3.31 Auditors must use professional judgment in planning and performing audits and attestation engagements and in reporting the results.

3.32 Professional judgment includes exercising reasonable care and professional skepticism. Reasonable care concerns acting diligently in accordance with applicable professional standards and ethical principles. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of evidence. Professional skepticism includes a mindset in which auditors assume neither that management is dishonest nor of unquestioned honesty. Believing that management is honest is not a reason to accept less than sufficient, appropriate evidence.

3.33 Using the auditors' professional knowledge, skills, and experience to diligently perform, in good faith and with integrity, the gathering of information and the objective evaluation of the sufficiency and appropriateness of evidence is a critical component of audits. Professional judgment and competence are interrelated because judgments made are dependent upon the auditors' competence.

3.34 Professional judgment represents the application of the collective knowledge, skills, and experiences of all the personnel involved with an assignment, as well as the professional judgment of individual auditors. In addition to personnel directly involved in the audit, professional judgment may involve collaboration with other stakeholders, outside experts, and management in the audit organization.

3.35 Using professional judgment in all aspects of carrying out their professional responsibilities, including following the independence standards, maintaining objectivity and credibility, assigning competent audit staff to the assignment, defining the scope of work, evaluating and reporting the results of the work, and maintaining appropriate quality control over the assignment process is essential to performing and reporting on an audit.

3.36 Using professional judgment is important in determining the required level of understanding of the audit subject matter and related circumstances. This includes consideration about whether the audit team's collective experience, training, knowledge, skills, abilities, and overall understanding are sufficient to assess the risks that the subject matter under audit may contain a significant inaccuracy or could be misinterpreted.

3.37 Considering the risk level of each assignment, including the risk that they may come to an improper conclusion is another important issue. Within the context of audit risk, exercising professional judgment in determining the sufficiency and appropriateness of evidence to be used to support the findings and conclusions based on the audit objectives and any recommendations reported is an integral part of the audit process.

3.38 Auditors should document significant decisions affecting the audit objectives, scope, and methodology; findings; conclusions; and recommendations resulting from professional judgment.

3.39 While this standard places responsibility on each auditor and audit organization to exercise professional judgment in planning and performing an audit or attestation engagement, it does not imply unlimited responsibility, nor does it imply infallibility on the part of either the individual auditor or the audit organization. Absolute assurance is not attainable because of the nature of evidence and the characteristics of fraud. Professional judgment does not mean eliminating all possible limitations or weaknesses associated with a specific audit, but rather identifying, considering, minimizing, mitigating, and explaining them.

Competence

3.40 The staff assigned to perform the audit or attestation engagement must collectively possess adequate professional competence for the tasks required.

3.41 The audit organization's management should assess skill needs to consider whether its workforce has the essential skills that match those necessary to fulfill a particular audit mandate or scope of audits to be performed. Accordingly, audit organizations should have a process for recruitment, hiring, continuous development, assignment, and evaluation of staff to maintain a competent workforce. The nature, extent, and formality of the process will depend on various factors such as the size of the audit organization, its structure, and its work.

3.42 Competence is derived from a blending of education and experience. Competencies are not necessarily measured by years of auditing experience because such a quantitative measurement may not accurately reflect the kinds of experiences gained by an auditor in any given time period. Maintaining competence through a commitment to learning and development throughout an auditor's professional life is an important element for auditors. Competence enables an auditor to make sound professional judgments.

Technical Knowledge and Competence

3.43 The staff assigned to conduct an audit or attestation engagement under GAGAS must collectively possess the technical knowledge, skills, and experience necessary to be competent for the type of work being performed before beginning work on that assignment. The staff assigned to a GAGAS audit or attestation engagement should collectively possess

- a.* knowledge of GAGAS applicable to the type of work they are assigned and the education, skills, and experience to apply this knowledge to the work being performed;
- b.* general knowledge of the environment in which the audited entity operates and the subject matter under review;
- c.* skills to communicate clearly and effectively, both orally and in writing; and
- d.* skills appropriate for the work being performed. For example, staff or specialist skills in
 - (1) statistical sampling if the work involves use of statistical sampling;
 - (2) information technology if the work involves review of information systems;
 - (3) engineering if the work involves review of complex engineering data;
 - (4) specialized audit methodologies or analytical techniques, such as the use of complex survey instruments, actuarial-based estimates, or statistical analysis tests, as applicable; or
 - (5) specialized knowledge in subject matters, such as scientific, medical, environmental, educational, or any other specialized subject matter, if the work calls for such expertise.

Additional Qualifications for Financial Audits and Attestation Engagements

3.44 Auditors performing financial audits should be knowledgeable in generally accepted accounting principles (GAAP), the American Institute of Certified Public Accountants (AICPA) generally accepted auditing standards for field work and reporting and the related Statements on Auditing Standards (SAS), and the application of these standards. Also, if auditors use GAGAS in conjunction with any other standards, they should be knowledgeable and competent in applying those standards. Auditors engaged to perform financial audits or attestation engagements should be licensed certified public accountants or persons working for a licensed certified public accounting firm or a government auditing organization.³³

3.45 Similarly, for attestation engagements, GAGAS incorporate the AICPA attestation standards. Auditors should be knowledgeable in the AICPA general attestation standard related to criteria, the AICPA attestation standards for field work and reporting, and the related Statements on Standards for Attestation Engagements (SSAE), and they should be competent in applying these standards and SSAE to the task assigned. Also, if auditors use GAGAS in conjunction with any other standards, they should be knowledgeable and competent in applying those standards.

Continuing Professional Education

3.46 Auditors performing work under GAGAS, including planning, directing, performing field work, or reporting on an audit or attestation engagement under GAGAS, should maintain their professional competence through continuing professional education (CPE). Therefore, each auditor performing work under GAGAS should complete, every 2 years, at least 24 hours of CPE that directly relates to government auditing, the government environment, or the specific or unique environment in which the audited entity operates. For auditors who are involved in any amount of planning, directing, or reporting on GAGAS assignments and those auditors who are not involved in those activities but charge 20 percent or more of their time annually to GAGAS assignments should also obtain at least an additional 56 hours of CPE (for a total of 80 hours of CPE in every 2-year period) that enhances the auditor's professional proficiency to perform audits or attestation engagements. Auditors required to take the total 80 hours of CPE should complete at least 20 hours of CPE in each year of the 2-year period.

3.47 CPE programs are structured educational activities with learning objectives designed to maintain or enhance participants' knowledge, skills, and abilities in areas applicable to performing audits or attestation engagements. Determining what subjects are appropriate for individual auditors to satisfy both the 80-hour and the 24-hour requirements is a matter of professional judgment to be exercised by auditors in consultation with appropriate officials in their audit organizations. Among the considerations in exercising that judgment are the auditors' experience, the responsibilities they assume in performing GAGAS assignments, and the operating environment of the audited entity.

3.48 Improving their own competencies and meeting CPE requirements are primarily the responsibilities of individual auditors. The audit organization should have quality control procedures to help ensure that auditors meet the continuing education requirements, including documentation of the CPE completed. The Government Accountability Office (GAO) has developed guidance pertaining to CPE requirements to assist auditors and audit organizations in exercising professional judgment in complying with the CPE requirements.³⁴

3.49 External specialists assisting in performing a GAGAS assignment should be qualified and maintain professional competence in their areas of specialization but are not required to meet the GAGAS CPE requirements described. However, auditors who use the work of external specialists should assess the professional qualifications of such specialists and document their findings and conclusions. Internal specialists who are part of the audit organization and perform as a member of the audit team should comply with GAGAS, including the CPE requirements.

Quality Control and Assurance

3.50 Each audit organization performing audits or attestation engagements in accordance with GAGAS must:

- a. establish a system of quality control that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements, and
- b. have an external peer review at least once every 3 years.³⁵

System of Quality Control

3.51 An audit organization's system of quality control encompasses the audit organization's leadership, emphasis on performing high quality work, and the organization's policies and procedures designed to provide reasonable assurance of complying with professional standards and applicable legal and regulatory requirements.³⁶ The nature, extent, and formality of an audit organization's quality control system will vary based on the audit organization's circumstances, such as the audit organization's size, number of offices and geographic dispersion, the knowledge and experience of its personnel, the nature and complexity of its audit work, and cost-benefit considerations.

3.52 Each audit organization must document its quality control policies and procedures and communicate those policies and procedures to its personnel. The audit organization should document compliance with its quality control policies and procedures and maintain such documentation for a period of time sufficient to enable those performing monitoring procedures and peer reviews to evaluate the extent of the audit organization's compliance with its quality control policies and procedures. The form and content of such documentation are a matter of professional judgment and will vary based on the audit organization's circumstances.

3.53 An audit organization should include policies and procedures in its system of quality control that collectively address:

a. Leadership responsibilities for quality within the audit organization: Policies and procedures that designate responsibility for quality of audits and attestation engagements performed under GAGAS and communication of policies and procedures relating to quality. Such policies and communications encourage a culture that recognizes that quality is essential in performing GAGAS audits.

b. Independence, legal, and ethical requirements: Policies and procedures designed to provide reasonable assurance that the audit organization and its personnel maintain independence, and comply with applicable legal and ethical requirements.³⁷

c. Initiation,³⁸ acceptance, and continuance of audit and attestation engagements: Policies and procedures for the initiation, acceptance, and continuance of audit and attestation engagements, designed to provide reasonable assurance that the audit organization will undertake audit engagements only if it can comply with professional standards and ethical principles and is acting within the legal mandate or authority of the audit organization.

d. Human resources: Policies and procedures designed to provide the audit organization with reasonable assurance that it has personnel with the capabilities and competence to perform its audits in accordance with professional standards and legal and regulatory requirements.³⁹

e. Audit and attestation engagement performance, documentation, and reporting: Policies and procedures designed to provide the audit organization with reasonable assurance that audits and attestation engagements are performed and reports are issued in accordance with professional standards and legal and regulatory requirements. (For financial audits, chapters 1 through 5 apply; for attestation engagements, chapters 1 through 3 and 6 apply; for performance audits, chapters 1 through 3 and 7 and 8 apply.)

f. Monitoring of quality: An ongoing, periodic assessment of work completed on audits and attestation engagements designed to provide management of the audit organization with reasonable assurance that the policies and procedures related to the system of quality control are suitably designed and operating effectively in practice. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of (1) adherence to professional standards and legal and regulatory requirements, (2) whether the quality control system has been appropriately designed, and (3) whether quality control policies and procedures are operating effectively and complied with in practice. Monitoring procedures will vary based on the audit organization's facts and circumstances. The audit organization should perform monitoring procedures that enable it to assess compliance with applicable professional standards and quality control policies and procedures for GAGAS audits.

Individuals performing monitoring should collectively have sufficient expertise and authority for this role.

3.54 The audit organization should analyze and summarize the results of its monitoring procedures at least annually, with identification of any systemic issues needing improvement, along with recommendations for corrective action. (Under GAGAS, reviews of the work and the report that are performed as part of supervision are not monitoring controls when used alone. However, these types of pre-issuance reviews may be used as a part of this analysis and summary.)

External Peer Review

3.55 Audit organizations performing audits and attestation engagements in accordance with GAGAS must have an external peer review performed by reviewers independent of the audit organization being reviewed at least once every 3 years.⁴⁰

3.56 The audit organization should obtain an external peer review sufficient in scope to provide a reasonable basis for determining whether, for the period under review,⁴¹ the reviewed audit organization's system of quality control was suitably designed and whether the audit organization is complying with its quality control system in order to provide the audit organization with reasonable assurance of conforming with applicable professional standards.

3.57 The peer review team should include the following elements in the scope of the peer review:

- a.** review of the audit organization's quality control policies and procedures;
- b.** consideration of the adequacy and results of the audit organization's internal monitoring procedures;
- c.** review of selected audit and attestation engagement reports and related documentation;
- d.** review of other documents necessary for assessing compliance with standards, for example, independence documentation, CPE records, and relevant human resource management files; and
- e.** interviews with a selection of the reviewed audit organization's professional staff at various levels to assess their understanding of and compliance with relevant quality control policies and procedures.

3.58 The peer review team should perform a risk assessment to help determine the number and types of engagements to select. Based on the risk assessment, the team should use one or a combination of the following approaches to selecting individual audits and attestation engagements for review: (1) select GAGAS audits and attestation engagements that provide a reasonable cross-section of the GAGAS assignments performed by the reviewed audit organization or
(2) select audits and attestation engagements that provide a reasonable cross-section from all types of work subject to the reviewed audit organization's quality control system, including one or more assignments performed in accordance with GAGAS.⁴²

3.59 The peer review team should prepare one or more written reports communicating the results of the peer review, including the following:

- a.** description of the scope of the peer review, including any limitations;
- b.** an opinion on whether the system of quality control of the reviewed audit organization's audit and/or attestation engagement practices was adequately designed and complied with during the period reviewed to provide the audit organization with reasonable assurance of conforming with applicable professional standards;
- c.** specification of the professional standards to which the reviewed audit organization is being held;

d. for modified or adverse opinions,⁴³ a description of reasons for the modification or adverse opinion, along with a detailed description of the findings and recommendations, in the peer review report, to enable the reviewed audit organization to take appropriate actions; and

e. reference to a separate letter of comments, if such a letter is issued.

3.60 The peer review team should meet the following criteria:

a. The review team collectively has current knowledge of GAGAS and government auditing.

b. The organization conducting the peer review and individual review team members are independent (as defined in GAGAS) of the audit organization being reviewed, its staff, and the audits and attestation engagements selected for the peer review.

c. The review team collectively has sufficient knowledge of how to perform a peer review. Such knowledge may be obtained from on-the-job training, training courses, or a combination of both. Having personnel on the peer review team with prior experience on a peer review or internal inspection team is desirable.

3.61 An external audit organization⁴⁴ should make its most recent peer review report⁴⁵ publicly available; for example, by posting the peer review report on an external Web site or to a publicly available file designed for public transparency of peer review results. If neither of these options is available to the audit organization, then it should use the same transparency mechanism it uses to make other information public, and also provide the peer review report to others upon request. Internal audit organizations that report internally to management should provide a copy of the external peer review report to those charged with governance. Government audit organizations should also communicate the overall results and the availability of their external peer review reports to appropriate oversight bodies.

3.62 Information in external peer review reports and letters of comment may be relevant to decisions on procuring audit or attestation engagements. Therefore, audit organizations seeking to enter into a contract to perform an audit or attestation engagement in accordance with GAGAS should provide the following to the party contracting for such services:

a. the audit organization's most recent peer review report and any letter of comment, and

b. any subsequent peer review reports and letters of comment received during the period of the contract.

3.63 Auditors who are using another audit organization's work should request a copy of the audit organization's latest peer review report and any letter of comment, and the audit organization should provide these documents when requested. (See paragraphs 3.05 and 7.41 through 7.43 for further requirements and guidance on using the work of others.)

20. Awareness and compliance with other independence standards and applicable ethics laws and regulations associated with their activities may also be required for auditors performing work in accordance with GAGAS.

21. Specialists to whom this section applies include, but are not limited to, actuaries, appraisers, attorneys, engineers, environmental consultants, medical professionals, statisticians, and geologists.

22. This includes those who review the work or the report, and all others within the audit organization who can directly influence the outcome of the audit. The period covered includes the period covered by the audit and the period in which the audit is being performed and reported.

23. Immediate family member is a spouse, spouse equivalent, or dependent (whether or not related). A close family member is a parent, sibling, or nondependent child.

24. Auditors are not precluded from auditing pension plans that they participate in if (1) the auditor has no control over the investment strategy, benefits, or other management issues associated with the pension plan and (2) the auditor belongs to such pension plan as part of his/her employment with the audit organization, provided that the plan is normally offered to all employees in equivalent employment positions.

25. Legislative bodies may exercise their confirmation powers through a variety of means so long as they are involved in the approval of the individual to head the audit organization. This involvement can be demonstrated by approving the individual after the appointment or by initially selecting or nominating an individual or individuals for appointment by the appropriate authority.

26. Statutory authority to issue a subpoena to obtain the needed records is one way to meet the requirement for statutory access to records.

27. The Government Accountability Office (GAO) has issued further guidance in the form of questions and answers to assist in implementation of the standards associated with nonaudit services. This guidance, *Government Auditing Standards: Answers to Independence Standard Questions*, GAO-02-870G (Washington, D.C.: June 2002), can be found on GAO's Government Auditing Standards Web page (<http://www.gao.gov/govaud/ybk01.htm>).

28. The concepts of significance and materiality include quantitative as well as qualitative measures in relation to the subject matter of the audit.

29. The requestor of nonaudit services could be the management of the audited entity or a third party such as a legislative oversight body.

30. The Office of Management and Budget (OMB) prohibits an auditor who prepared the entity's indirect cost proposal from conducting the required audit when indirect costs recovered by the entity during the prior year exceeded \$1 million under OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Subpart C.305(b), revised June 27, 2003.

31. Entity assets are intended to include all of the entity's property including bank accounts, investment accounts, inventories, equipment, or other assets owned, leased, or otherwise in the entity's possession, and financial records, both paper and electronic.

32. Personnel who provided the nonaudit service are permitted to convey to the audit team the documentation and knowledge gained about the audited entity and its operations.

33. Public accountants licensed on or before December 31, 1970, or persons working for a public accounting firm licensed on or before December 31, 1970, are also considered qualified under this standard.

34. This guidance, *Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education*, GAO-05-568G (Washington, D.C.: April 2005), can be found on GAO's Government Auditing Standards Web page (<http://www.gao.gov/govaud/ybk01.htm>).

35. An audit organization's noncompliance with the peer review requirements (paragraph 3.50b and 3.55 through 3.60) results in a modified GAGAS compliance statement. The audit organization's compliance (or noncompliance) with the requirements for a system of quality control in paragraphs 3.50a and 3.51 through 3.54 are tested and reported on as part of the peer review process and do not impact the GAGAS compliance statement. (See chapter 1, paragraphs 1.11 through 1.13.)

36. The system of quality control discussed in this section is consistent with the AICPA proposed statement on Quality Control Standards, *A Firm's System of Quality Control*, except that the GAGAS requirements in paragraph 3.54 state that reviews of the work and the report that are performed as part of supervision are not monitoring controls when used alone.

37. See paragraphs 3.02 through 3.30 for GAGAS dealing with independence. See chapter 2 for GAGAS ethical principles. Individual auditors who are members of professional organizations or are licensed or certified professionals may also be subject to ethical requirements of those professional organizations or licensing bodies. Auditors in government entities may also be subject to government ethics laws and regulations.

38. Government audit organizations initiate audit and attestation engagements as a result of (1) the audit organization's discretion, (2) requests from legislative bodies or oversight bodies, and (3) legal mandates. In the case of requests and legal mandates, a government audit organization may be required to do the work. See paragraph 3.04 for requirements where an audit organization in a government entity is not independent and, because of a legislative requirement or for other reasons, cannot decline to perform the work.

39. See paragraphs 3.40 through 3.49 for requirements dealing with professional competence.

40. The external peer review requirement is effective within 3 years from the date an audit organization begins field work on its first assignment in accordance with GAGAS for both financial audit practices and performance audit practices. Generally, the deadlines for peer review reports are established by the entity that administers the peer review program. Extensions of the deadlines for submitting the peer review report exceeding 3 months beyond the due date are granted by the entity that administers the peer review program and GAO.

41. The period under review generally covers 1 year. Peer review programs and audit organizations may choose a longer period to be covered by the peer review.

42. The second approach is generally applicable to audit organizations that perform only a small number of GAGAS audits in relation to other types of audits. In these cases, one or more GAGAS audits may represent more than what would be selected when looking at a cross-section of the audit organization's work as a whole.

43. A modified opinion is an opinion in which the peer reviewer concludes that except for the effects of deficiencies described in the report, the system of quality control was adequately designed and complied with during the period. An adverse opinion is a conclusion that the system of quality control was not adequately designed and complied with to provide reasonable assurance of conforming with professional standards.

44. An external audit organization is defined in paragraphs 3.13 through 3.15.

45. This requirement does not include the letter of comment.